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14 August 1984

MEMORANDUM FOR: Associate Deputy Director for Intelligence

VIA : Director, Office of European Analysis
Chief, East European Division
Chief, East-West Regional Branch

FROM : [redacted] EURA/EE/EW 25X1

SUBJECT : Request Permission to give Oral Presentation

1. I request permission to give a talk on financial problems in the Balkans (see attached text).

2. When approved, I intend to give the talk at the Annual [redacted] 25X1

3. None of the material in the oral presentation is, to my knowledge, classified and I will not engage in policy prescription.

4. [redacted] I will be identified as an Agency employee but will append the standard disclaimer indicating that the views expressed are my own and not necessarily those of the agency. 25X1

[redacted] 25X1

[redacted] 25X1

20 AUG 1984
Date

Director, Office of European Analysis

Actions

APPRO [redacted] 25X1

28 AUG 1984
Date

Associate Deputy Director for Intelligence

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Financial Problems in the Balkans

I. Introduction

A. Eastern Europe's debt crisis did not spare the Balkans. (Indeed, the rise of Romania's financial difficulties so soon after Poland's did much to weaken bankers' confidence.

B. Yet crisis hit the three--Bulgaria, Romania, and Yugoslavia--much differently. (Albania not included in this talk as "foreign debt" is against the law.)

1. The severity differed among the three.

2. Different responses to the crisis.

a. By the regimes.

b. By private creditors.

3. Their reactions have different long-term implications.

II. Romania

A. Its difficulties were only tangentially related to bankers' concerns about Poland. Romania had its own economic difficulties.

1. Romania had growing arrearages in summer 1981.

2. Coupled with growing percentage of short term debt. (estimated by some to be as high as 40-50 percent of a total debt of $10 billion.)

3. Also growing concern about the soundness of overall growth strategy--especially the continued pursuit

of rapid growth based on energy intensive heavy industrialization.

4. Soon bankers withdrew short-term credit lines, which intensified the liquidity problem.

B. Romania was hurt by own responses.

1. Press reported that Romanians initially ignored problems or denied existence.

2. Lack of information and data also did not help.

C. By early 1982 it was forced to reschedule debts with both private and government creditors, although rescheduling with banks not completed until late 1982.

D. Along with debt relief Bucharest imposed harsh austerity measures at home.

1. Result was drop in consumption and very slow growth in industrial output (both fell to postwar lows).

2. But Bucharest generated large trade surpluses that helped pay down debts. (e.g. a $1.5 billion deficit in 1980 turned into a $1.5 billion surplus by 1982).

E. 1983 was a repeat of 1982.

1. Reschedulings were quicker, however.

2. Austerity continued at home to further reduce debt to about $9 billion.

F. Bucharest plans for further improvements on the financial front this year.

1. Another large surplus forcasted.

2. No rescheduling.

3. And doing so without an IMF program.

III. Yugoslavia

A. Its problems arose only in small part due to bankers' pullout.

B. Mostly due to own failure to control rising trade and current account deficits. (In 1979 had a $7 billion dollar hard currency trade deficit. Its debt of around $19 billion in 1981 was larger than Polands on either a per capita basis or as a percentage of GNP.)

1. To some extent these problems are the result of external factors--e.g. oil price hikes and Western recession and protectionism.

2. But they are largely the result of ongoing decentralization.

a. Yet economy not free enough to ensure microeconomic efficiency.

b. And not enough authority in Belgrade to impose adequate stablization measures.

C. Led to 1983 Western rescue package.

1. Worth over $5 billion, involved 600 banks, 16 nations, IMF and BIS.

D. Coupled with stabilization program at home (in conjunction with IMF program), which slowed growth markedly from the high growth rates of the 1970s.

E. Result was to stabilize debt (only marginal growth), to cut trade deficit sharply (fell to well under $2 billion in both 1982 and 1983), to generate first current

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account surplus in over a decade, to slow growth of domestic economy.

F. Nonetheless, more help needed in 1984.

   1. Key hinged on completing IMF standby agreement--a one-year package worth $400 million.

      a. Negotiations harder than before.

      b. Debate with Fund over pace of adjustment (like problem of many LDCs).

      c. Fund wanted real interest rates, eliminination of a price freeze, exchange rate adjustments, and reduced subsidies to enterprises.

      d. At one point Yugoslav officials publicly said they were willing to "go it alone" without financial assistance.

      e. Compromise reached when Fund agreed to slow pace of adjustment.

      f. Minor squabble still delayed first drawing.

   2. Other financial packages soon followed--government package worth $800 million, and bank's worth $1.2 billion.

G. Belgrade continues austerity at home and now seeking multi-year refinancing package.

IV. Bulgaria

A. For most part, unaffected by credit crunch.

B. Few financial problems.

   1. Conservative borrowing strategy since mid-1970s.

   2. Massive reliance on Soviet trade.

3. Result was only minor reduction in bank exposure.

C. Strong financial improvements continue this year.

1. Sofia continuing to run trade and current account surpluses to pay down debts.

2. Probably could borrow if wanted to given strong position.

V. <u>Long-Term Implications</u>

A. On surface, Bulgaria looks best off while Yugoslavia looks the weakest.

1. Yet <u>Bulgaria</u> counts heavily on continued Soviet support.

a. For 60% of trade, 2/3 of energy consumption.

b. But Soviet support showing signs of weakening (e.g. rising energy prices, reduced trade deficits, etc.)

c. And trade links with West not well established.

d. Much of recent hard currency surpluses come from resales of oil to developed West and sales of other goods to third world. Both show signs of weakening.

2. <u>Romania's</u> financial improvement due largely to draconian import cuts (over 40% in 1981-82) and maintaining large volume of oil product sales to Western Europe.

a. Questions remain as to how long import reductions can continue and whether exports other than oil will pickup.

b. Austerity at home the past three years also likely to slow future growth.

c. Relief from debt reschedulings ends next year.

3. Yugoslavia's position is hard to get a handle on.

a. While still needing some debt relief, situation is improving.

b. Key is whether ongoing attempts at reforms can produce system which can generate enough exports to maintain creditworthiness in the long run.